



# MICHIGAN

OFFICE OF THE AUDITOR GENERAL

## AUDIT REPORT



THOMAS H. MCTAVISH, C.P.A.  
AUDITOR GENERAL

“...The auditor general shall conduct post audits of financial transactions and accounts of the state and of all branches, departments, offices, boards, commissions, agencies, authorities and institutions of the state established by this constitution or by law, and performance post audits thereof.”

– Article IV, Section 53 of the Michigan Constitution

Audit report information may be accessed at:

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Michigan  
*Office of the Auditor General*  
**REPORT SUMMARY**

***Financial Audit***

*Including the Provisions of the Single Audit Act*

***Michigan Economic Development Corporation***

*(A Component Unit of the State of Michigan)*

*October 1, 2002 through September 30, 2004*

Report Number:  
64-805-05

Released:  
June 2005

*A Single Audit is designed to meet the needs of all financial report users, including an entity's federal grantor agencies. The audit determines if the financial schedules and/or financial statements are fairly presented; considers internal control over financial reporting and internal control over federal program compliance; determines compliance with State compliance requirements material to the financial schedules and/or financial statements; and assesses compliance with direct and material requirements of the major federal programs.*

***Financial Statements:***

**Auditor's Report Issued**

We issued an unqualified opinion on the Michigan Economic Development Corporation's (MEDC's) financial statements.

~ ~ ~ ~ ~

**Internal Control Over Financial Reporting**

We did not report any findings related to internal control over financial reporting.

~ ~ ~ ~ ~

**Noncompliance or Other Matters Material  
to the Financial Statements**

We did not identify any instances of noncompliance or other matters applicable to the financial statements that are required to be reported under *Government Auditing Standards*.

~ ~ ~ ~ ~

***Federal Awards:***

**Auditor's Reports Issued on Compliance**

We audited 2 programs as major programs and issued 2 unqualified opinions. The federal programs audited as major programs are identified on the back of this summary.

~ ~ ~ ~ ~

**Internal Control Over Major Programs**

We did not report any findings related to internal control over major programs.

~ ~ ~ ~ ~

**Required Reporting of Noncompliance**

We did not identify any instances of noncompliance that are required to be reported in accordance with U.S. Office of Management and Budget (OMB) Circular A-133.

~ ~ ~ ~ ~

We audited the following programs as major programs:

<b><u>CFDA Number</u></b>	<b><u>Program Title</u></b>	<b><u>Compliance Opinion</u></b>
11.611	Manufacturing Extension Partnership	Unqualified
17.207	Employment Service	Unqualified

A copy of the full report can be  
obtained by calling 517.334.8050  
or by visiting our Web site at:  
<http://audgen.michigan.gov>



Michigan Office of the Auditor General  
201 N. Washington Square  
Lansing, Michigan 48913

**Thomas H. McTavish, C.P.A.**  
Auditor General

**Scott M. Strong, C.P.A., C.I.A.**  
Deputy Auditor General



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THOMAS H. MCTAVISH, C.P.A.  
AUDITOR GENERAL

June 30, 2005

Mr. Donald Jakeway, President and Chief Executive Officer  
Michigan Economic Development Corporation  
300 North Washington Square  
Lansing, Michigan

Dear Mr. Jakeway:

This is our report on the financial audit, including the provisions of the Single Audit Act, of the Michigan Economic Development Corporation (MEDC) for the period October 1, 2002 through September 30, 2004.

This report contains our report summary; independent auditor's report on the financial statements; the MEDC management's discussion and analysis; and the MEDC financial statements, notes to the financial statements, and schedule of expenditures of federal awards. This report also contains our independent auditor's report on internal control over financial reporting and on compliance and other matters, our independent auditor's report on compliance with requirements applicable to each major program and on internal control over compliance in accordance with U.S. Office of Management and Budget Circular A-133, and our schedule of findings and questioned costs. In addition, the report contains MEDC's summary schedule of prior audit findings and a glossary of acronyms and terms.

We appreciate the courtesy and cooperation extended to us during this audit.

Sincerely,

A handwritten signature in black ink that reads "Thomas H. McTavish".

Thomas H. McTavish, C.P.A.  
Auditor General

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# INDEPENDENT AUDITOR'S REPORT



STATE OF MICHIGAN  
OFFICE OF THE AUDITOR GENERAL  
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THOMAS H. MCTAVISH, C.P.A.  
AUDITOR GENERAL

## Independent Auditor's Report on the Financial Statements

Mr. Donald Jakeway, President and Chief Executive Officer  
Michigan Economic Development Corporation  
300 North Washington Square  
Lansing, Michigan

Dear Mr. Jakeway:

We have audited the financial statements of the Michigan Economic Development Corporation, a component unit of the State of Michigan, as of and for the fiscal years ended September 30, 2004 and September 30, 2003, as identified in the table of contents. These financial statements are the responsibility of the Michigan Economic Development Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 1, the financial statements present only the Michigan Economic Development Corporation and do not purport to, and do not, present fairly the financial position of the State of Michigan or its component units as of September 30, 2004 and September 30, 2003 and the changes in financial position and cash flows thereof for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

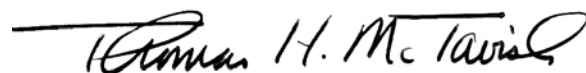
In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Michigan Economic Development Corporation as of September 30, 2004 and September 30, 2003 and the changes in financial position and cash flows for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis for the fiscal year ended September 30, 2004 on pages 11 through 17 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it. The management's discussion and analysis for the fiscal year ended September 30, 2003 was not presented because this information was presented with the Michigan Economic Development Corporation's prior year's audited financial statements.

In accordance with *Government Auditing Standards*, we have also issued a report dated March 15, 2005 on our consideration of the Michigan Economic Development Corporation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of the internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The schedule of expenditures of federal awards, required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, is presented for purposes of additional analysis and is not a required part of the Michigan Economic Development Corporation's financial statements referred to in the first paragraph. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

Sincerely,

A handwritten signature in black ink, reading "Thomas H. McTavish". The signature is fluid and cursive, with a horizontal line extending from the left side of the name.

Thomas H. McTavish, C.P.A.  
Auditor General  
March 15, 2005

## MANAGEMENT'S DISCUSSION AND ANALYSIS

This is a discussion and analysis of the financial performance of the Michigan Economic Development Corporation (MEDC) for the fiscal year ended September 30, 2004. MEDC is a public body corporate and a component unit of the financial reporting entity of the State of Michigan. MEDC's management is responsible for the financial statements, notes to the financial statements, and this discussion.

### **Using the Financial Report**

This financial report is prepared in accordance with Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*.

The reporting standards require a statement of net assets; a statement of revenues, expenses, and changes in fund net assets; and a statement of cash flows (direct method).

This financial report includes the reports of independent auditors, management's discussion and analysis, the basic financial statements, and the notes to the financial statements.

Amounts reported in the financial statements include both the MEDC corporate funds as well as the portion of the State appropriations made available to MEDC.

The financial statements are interrelated and represent the financial status of MEDC. The statement of net assets presents assets and liabilities as of the end of the fiscal year.

The statement of revenues, expenses, and changes in fund net assets presents the revenues earned and expenses incurred during the fiscal year.

The statement of cash flows presents information related to cash in-flows and out-flows summarized by operating, capital acquisition, and investing activities.

### **Analysis of Financial Activities**

The assets of MEDC exceeded its liabilities at September 30, 2004 by \$166.6 million and by \$220.9 million at September 30, 2003. As of September 30, 2004, \$74.1 million of this amount was in equity in common cash of the State of Michigan.

MEDC's total net assets decreased by \$54.2 million during the course of fiscal year 2003-04 operations.

**Condensed Financial Information**  
**From the Statement of Net Assets**  
As of September 30

	2004	2003
Current assets	\$ 104,727,759	\$ 167,090,807
Noncurrent assets:		
Investments	31,239,900	35,298,130
Loans receivable	35,944,925	26,103,269
Capital assets (net)	11,941,209	13,229,654
Other noncurrent assets	5,614,856	7,689,002
Total Assets	<u>\$ 189,468,649</u>	<u>\$ 249,410,863</u>
Current liabilities	\$ 16,292,804	\$ 21,747,688
Long-term liabilities	6,547,386	6,811,404
Total Liabilities	<u>\$ 22,840,190</u>	<u>\$ 28,559,091</u>
Net Assets		
Invested in capital assets	\$ 11,941,209	\$ 13,229,654
Unrestricted net assets	154,687,251	207,622,117
Total Net Assets	<u>\$ 166,628,460</u>	<u>\$ 220,851,772</u>

**Current assets** primarily consist of amounts retained by the State of Michigan in its equity in common cash for the unspent appropriations (details are provided at the end of this discussion and analysis), cash and cash equivalents, short-term investments, and loans receivable. Interest earned on funds retained in the common cash pool is the income for the State and does not get transferred to MEDC.

MEDC receives tribal gaming revenue directly from the Keweenaw Bay Indian Community under a consent agreement reached by the Keweenaw Bay Indian Community, the federal government, and the State government.

**Current assets** declined significantly primarily because of a decrease in MEDC's equity in common cash from \$130.5 million at September 30, 2003 to \$74.1 million at

September 30, 2004. The decline was primarily attributable to the disbursement of amounts committed in prior fiscal years for the Life Sciences Program (\$30.1 million), Economic Development Job Training Program (\$10.2 million), and Michigan Core Community Fund Program (\$13.0 million).

**Current assets** also declined because there were no amounts due from MSF (for tribal gaming revenues accrued by MSF) at September 30, 2004. MSF receives an 8% share of the net revenues collected from two Indian tribes in accordance with the terms of the tribes' 1998 compact agreement with the State, which is then transferred to MEDC. The amount of the transfer from MSF decreased significantly during fiscal year 2003-04 because the tribes contend that the Club Keno game, introduced by the State Lottery, violated the terms of the compact agreement. The tribes placed the payments for fiscal year 2003-04 into an escrow account rather than submitting them to MSF, pending the resolution of this matter. Based on information provided by the tribes, MSF estimated that the tribes placed approximately \$10.7 million into the escrow account relating to fiscal year 2003-04. MEDC recorded an amount due from MSF, relating to tribal gaming revenues of \$6.4 million as of September 30, 2003.

**Investments** include long-term securities and program investments. During fiscal year 2003-04, total investments (short-term and long-term) declined by \$2.2 million compared with fiscal year 2002-03 primarily because of the liquidation of investments necessary to pay for program grant commitments made in earlier fiscal years by MSF netted against new program investments for the Life Sciences Program and a reduction in unrealized losses compared to the prior fiscal year.

**Loans receivable** include only the long-term portion of the outstanding loans net of loan loss provisions. Total loans receivable (short-term and long-term) increased by \$8.9 million in fiscal year 2003-04 when compared with fiscal year 2002-03 because of new program loans (\$12.5 million) netted against program loan repayments (\$1.8 million), loan write-offs (\$0.5 million) and conversion of loan to investment (\$1.3 million).

**Capital assets (net)** at September 30, 2004 include the cost of the MEDC headquarters building, furniture, and information technology equipment, net of depreciation. During fiscal year 2003-04, capital assets worth \$116,376 were added.

**Other noncurrent assets** consist of Capital Access Program loan guarantee reserves. The Program ended on September 30, 2002 and no new loans are enrolled. However, MEDC will continue to process claims and recoveries until the reserves are exhausted.

**Current liabilities** primarily consist of accounts payables and the current portion of the liability for the Capital Access Program loan guarantee. The current liabilities decreased by \$5.5 million during fiscal year 2003-04 primarily due to a significant decrease in accounts payable for the Economic Development Job Training Program (because of reduced funding available resulting in reduced expenses and year-end liability) and the liability for the Capital Access Program loan guarantee (because the Program ended on September 30, 2002 and no new loans are enrolled) offset by an increase in accounts payable for the Life Sciences Program (because the grants were awarded late in the fiscal year and payments due at September 30, 2004 were made in October).

**Long-term liabilities** primarily consist of Capital Access Program loan guarantee reserves.

Overall, **net assets** were reduced by approximately \$54.2 million during fiscal year 2003-04 as a result of the preceding activities.



**Condensed Financial Information**  
**From the Statement of Revenues, Expenses, and Changes in Fund Net Assets**  
For the Fiscal Years Ended September 30

	2004	2003
Operating Revenues		
Operating grants and contributions	\$ 53,842,540	\$ 102,450,094
Interest and investment earnings	2,595,052	542,948
Other operating revenues	2,954,945	3,407,354
Total Operating Revenues	<u>\$ 59,392,537</u>	<u>\$ 106,400,397</u>
Operating Expenses		
Salaries, wages, and other administrative expenses	\$ 35,848,540	\$ 42,726,031
Payment to MSF	15,210	12,775
Operating grants	77,752,099	107,166,735
Total Operating Expenses	<u>\$ 113,615,848</u>	<u>\$ 149,905,541</u>
Change in net assets	\$ (54,223,312)	\$ (43,505,144)
Total net assets - Beginning	220,851,772	264,356,916
Total net assets - Ending	<u>\$ 166,628,460</u>	<u>\$ 220,851,772</u>

**Operating grants and contributions** include grants received from the National Institute of Standards and Technology (NIST), a federally funded program; the amount received from State appropriations for the economic development functions; and tribal gaming revenue, fees, etc., received by MSF and transferred to MEDC.

**Operating grants and contributions** decreased significantly mainly because of substantial reductions in funding available to MEDC from State appropriations (because of legislative actions) and tribal gaming revenues from MSF (because of funds withheld by two Indian tribes, as previously explained) during fiscal year 2003-04.

**Interest and investment earnings** performed reasonably well during fiscal year 2003-04 because of the continued recovery of overall stock and bond market conditions and the recognition of the difference between cost and market value of the investments as of September 30, 2004 compared with October 1, 2003. As of September 30, 2004, the market value of MEDC investments was \$9.2 million lower than the cost. As of September 30, 2003, the market value of MEDC investments was \$9.7 million lower

than the cost. As a result, \$0.5 million was recorded as revenue to reflect the net increase in market value of MEDC investments on September 30, 2004.

**Other operating revenues** primarily consisted of tribal gaming revenues. As a result of a consent judgment reached by the Keweenaw Bay Indian Community, the U.S. Department of the Interior, the U.S. Department of Justice, and the Governor during fiscal year 2000-01, MEDC receives a semi-annual payment from the Keweenaw Bay Indian Community in an amount equal to 8% of the net win derived from all class III electronic games of chance. During fiscal year 2003-04, MEDC received \$2.5 million compared to \$2.6 million received in fiscal year 2002-03.

**Salaries, wages, and other administrative expenses** decreased because of staffing reductions, cost savings from mandatory furloughs and retirement rate adjustments for State employees, and cost reductions per executive directive for purchased services. Also, in fiscal year 2002-03 these expenses included a \$4.5-million write-off of loans receivable compared to a \$0.5-million write-off during fiscal year 2003-04.

**Operating grants** primarily include grants for the Life Sciences Program, Economic Development Job Training Program, Michigan Core Community Fund Program, and technical training programs. There was a significant decrease in fiscal year 2003-04 when compared to the prior year because of a one-time grant of \$30 million for the Next Energy Program during fiscal year 2002-03.

**Condensed Financial Information**  
**From the Statement of Cash Flows**  
For the Fiscal Years Ended September 30

	2004	2003
Cash provided (used) by:		
Operating activities	\$ (63,511,886)	\$ (50,625,854)
Capital and related financing activities	(116,376)	(77,307)
Investing activities	4,507,709	8,507,410
Net increase (decrease) in cash	\$ (59,120,553)	\$ (42,195,751)
Cash and cash equivalents at beginning of year	143,615,457	185,811,208
Cash and cash equivalents at end of year	<u>\$ 84,494,904</u>	<u>\$ 143,615,457</u>

The decline in **cash and cash equivalents** from fiscal year 2002-03 was attributable to amounts committed in prior fiscal years for the Life Sciences Program, Economic Development Job Training Program, and Michigan Core Community Fund Program but disbursed during fiscal year 2003-04.

Cash and cash equivalents at the end of fiscal year 2003-04 (\$84.5 million) included \$74.1 million equity in the State of Michigan common cash. It is earmarked for the following obligations of MEDC:

Program	Amount
Life Sciences Program	\$ 43,423,383
Economic Development Job Training Program	12,986,098
Michigan Core Community Fund Program	3,366,774
Automotive Technological Accelerator	1,310,000
Michigan Growth Fund	477,993
Miscellaneous	3,327,698
Accounts payable*	9,232,970
Total Equity in State of Michigan Common Cash	<u>\$ 74,124,915</u>

\* This amount represents payments made after September 30, 2004 against the obligations of fiscal year 2003-04.

The balance of the cash on hand (\$10.4 million) represented investments in instruments with maturity dates of less than 12 months.

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# FINANCIAL STATEMENTS

**MICHIGAN ECONOMIC DEVELOPMENT CORPORATION**

Statement of Net Assets

As of September 30

	<u>2004</u>	<u>2003</u>
<b>ASSETS</b>		
Current Assets:		
Cash (Note 2)	\$ 70,041	\$ 51,285
Equity in common cash (Note 2)	74,124,915	130,544,190
Capital Access Program - Cash (Note 2)	442,399	414,979
Short-term notes (Note 2)	4,242,693	4,916,001
Tribal gaming revenue receivable (Note 8)	1,349,829	1,330,000
Amounts due from MSF		6,366,057
Amounts due from federal agencies	375,129	171,467
Investments (Note 2)	22,796,477	20,928,238
Other Current Assets:		
Loans receivable (Note 4)	956,164	1,906,128
Interest receivable	169,208	364,481
Miscellaneous	200,904	97,982
Total Current Assets	<u>\$ 104,727,759</u>	<u>\$ 167,090,807</u>
Noncurrent Assets:		
Capital Access Program - Reserve (Note 2)	\$ 5,614,856	\$ 7,689,002
Loans receivable (Note 4)	35,944,925	26,103,269
Investments (Note 2)	31,239,900	35,298,130
Capital assets (net) (Note 5)	11,941,209	13,229,654
Total Noncurrent Assets	<u>\$ 84,740,890</u>	<u>\$ 82,320,056</u>
Total Assets	<u>\$ 189,468,649</u>	<u>\$ 249,410,863</u>
<b>LIABILITIES</b>		
Current Liabilities:		
Accounts payable and other liabilities	\$ 12,150,512	\$ 16,711,271
Compensated absences (Notes 6 and 7)	1,541,810	942,345
Amounts due to primary government	125,957	94,072
Capital Access Program (Note 6)	2,000,000	4,000,000
Deferred revenues	474,524	
Total Current Liabilities	<u>\$ 16,292,804</u>	<u>\$ 21,747,688</u>
Long-Term Liabilities:		
Capital Access Program (Note 6)	\$ 3,614,856	\$ 3,689,002
Compensated absences (Notes 6 and 7)	675,822	821,502
Other long-term liabilities	2,256,708	2,300,899
Total Long-Term Liabilities	<u>\$ 6,547,386</u>	<u>\$ 6,811,404</u>
Total Liabilities	<u>\$ 22,840,190</u>	<u>\$ 28,559,091</u>
<b>NET ASSETS</b>		
Invested in capital assets	\$ 11,941,209	\$ 13,229,654
Unrestricted net assets	154,687,251	207,622,117
Total Net Assets (Note 9)	<u>\$ 166,628,460</u>	<u>\$ 220,851,772</u>

The accompanying notes are an integral part of the financial statements.

**MICHIGAN ECONOMIC DEVELOPMENT CORPORATION**  
**Statement of Revenues, Expenses, and Changes in Fund Net Assets**  
**For the Fiscal Years Ended September 30**

	<u>2004</u>	<u>2003</u>
<b>OPERATING REVENUES</b>		
<u>Operating Grants and Contributions</u>		
Federal revenue - Manufacturing Extension Partnership (NIST)	\$ 2,335,445	\$ 2,223,078
Payments from MSF - State appropriations (Note 3)	48,692,604	85,937,508
Payments from MSF - Tribal gaming revenue, fees, etc. (Note 3)	2,814,491	14,289,508
Total Operating Grants and Contributions	<u>\$ 53,842,540</u>	<u>\$ 102,450,094</u>
<u>Interest and Investment Earnings</u>		
Investment earnings	\$ 1,569,932	\$ 2,806,188
Net increase (decrease) in fair value of investments	525,093	(2,883,335)
Interest income on loans	472,608	556,494
Interest income	27,420	63,602
Total Interest and Investment Earnings	<u>\$ 2,595,052</u>	<u>\$ 542,948</u>
<u>Other Operating Revenues</u>		
Tribal gaming revenue (Note 8)	\$ 2,527,044	\$ 2,609,780
Other operating revenues	427,900	797,574
Total Other Operating Revenues	<u>\$ 2,954,945</u>	<u>\$ 3,407,354</u>
Total Operating Revenues	<u>\$ 59,392,537</u>	<u>\$ 106,400,397</u>
<b>OPERATING EXPENSES</b>		
Salaries, wages, and other administrative expenses	\$ 35,394,755	\$ 43,213,855
Compensated absences (Note 7)	453,785	(487,824)
Payment to MSF	15,210	12,775
Operating grants	77,752,099	107,166,735
Total Operating Expenses	<u>\$ 113,615,848</u>	<u>\$ 149,905,541</u>
Operating Income (Loss)	<u>\$ (54,223,312)</u>	<u>\$ (43,505,144)</u>
Nonoperating Revenues (Expenses)	<u>\$ 0</u>	<u>\$ 0</u>
Transfers	<u>\$ 0</u>	<u>\$ 0</u>
Change in net assets	\$ (54,223,312)	\$ (43,505,144)
Total net assets - Beginning	<u>220,851,772</u>	<u>264,356,916</u>
Total net assets - Ending	<u>\$ 166,628,460</u>	<u>\$ 220,851,772</u>

The accompanying notes are an integral part of the financial statements.

**MICHIGAN ECONOMIC DEVELOPMENT CORPORATION**  
Statement of Cash Flows  
For the Fiscal Years Ended September 30

	2004	2003
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Payments to employees	\$ (17,865,598)	\$ (18,544,999)
Payments to suppliers	(16,136,641)	(24,116,793)
Tribal gaming revenue	2,507,216	2,479,780
Other operating revenue	797,586	1,354,068
Grants received from federal government	2,131,783	2,051,611
Operating grants	(92,804,173)	(112,863,015)
Payment to MSF	(15,210)	(12,775)
Payments from MSF	57,873,151	99,026,269
Net cash provided (used) by operating activities	<u>\$ (63,511,886)</u>	<u>\$ (50,625,854)</u>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES</b>		
Net cash provided (used) by noncapital financing activities	<u>\$ 0</u>	<u>\$ 0</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
Acquisition and construction of capital assets (Note 5)	\$ (116,376)	\$ (77,307)
Net cash provided (used) by capital and related financing activities	<u>\$ (116,376)</u>	<u>\$ (77,307)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Proceeds from sale and maturities of investment securities (Note 2)	\$ 2,715,085	\$ 5,637,621
Interest and dividends on investments	1,792,624	2,869,789
Net cash provided (used) by investing activities	<u>\$ 4,507,709</u>	<u>\$ 8,507,410</u>
 Net cash provided (used) - all activities	 \$ (59,120,553)	 \$ (42,195,751)
Cash and cash equivalents at beginning of year	143,615,457	185,811,208
Cash and cash equivalents at end of year	<u><u>\$ 84,494,904</u></u>	<u><u>\$ 143,615,457</u></u>
<b>RECONCILIATION OF CASH AND CASH EQUIVALENTS</b>		
Per statement of net assets classifications:		
Cash	\$ 70,041	\$ 51,285
Equity in common cash	74,124,915	130,544,190
Capital Access Program	6,057,255	8,103,981
Short-term notes	4,242,693	4,916,001
Cash and cash equivalents at end of year	<u><u>\$ 84,494,904</u></u>	<u><u>\$ 143,615,457</u></u>
<b>RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES:</b>		
Operating income (loss)	\$ (54,223,312)	\$ (43,505,144)
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:		
Interest (nonprogram) and investment income	(1,792,624)	(2,869,789)
Depreciation	1,404,821	1,500,137
Net increase (decrease) in fair value of investments	(525,093)	2,883,335
Changes in assets and liabilities:		
Amounts due from component unit (MSF)	6,366,057	(1,766,057)
Mortgages and loans receivable (program loans)	(8,891,693)	(404,897)
Amounts due from federal agencies	(203,662)	(171,467)
Other assets	72,522	(152,982)
Accounts payable and other liabilities	(5,718,902)	(6,138,989)
Net cash provided (used) by operating activities	<u><u>\$ (63,511,886)</u></u>	<u><u>\$ (50,625,854)</u></u>
<b>SCHEDULE OF NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES</b>		
Loan converted to investment	\$ 1,260,828	\$ 1,510,396
Investment converted to loan		(545,896)
Increase/(decrease) in fair market value of investments	525,093	(2,883,335)
Net noncash provided (used) by investing, capital, and financing activities	<u><u>\$ 1,785,921</u></u>	<u><u>\$ (1,918,835)</u></u>

The accompanying notes are an integral part of the financial statements.



## Notes to the Financial Statements

### Note 1 Significant Accounting Policies

The accounting policies of the Michigan Economic Development Corporation (MEDC) conform to accounting principles generally accepted in the United States of America as applicable to governmental units. The following is a summary of the more significant policies:

#### a. Reporting Entity

Article VII, Section 28 of the State Constitution and Act 7, P.A. 1967, provided for the creation of MEDC as a public body corporate. MEDC was created by a 10-year contract (interlocal agreement, as amended) between a participating local economic development corporation formed under Act 338, P.A. 1974, as amended, and the Michigan Strategic Fund (MSF). MEDC is a separate legal entity created to promote smart economic growth by developing strategies and providing services to create and retain good jobs and a high quality of life for Michigan residents. Under the terms of the agreement, the governance of MEDC resides in an Executive Committee of 20 members appointed to eight-year, staggered terms by the Governor.

MEDC is a component unit of the financial reporting entity of the State of Michigan. The decision to include a potential component unit in the reporting entity is made by applying the criteria set forth in Governmental Accounting Standards Board (GASB) Statement No. 14, *The Financial Reporting Entity*. The basic criteria include the appointment of a voting majority of the governing board of MEDC; the legal separation of the State and MEDC; the fiscal independence of MEDC; whether exclusion of the unit would make the *State of Michigan Comprehensive Annual Financial Report (SOMCAFR)* misleading; and whether there is a potential for MEDC to provide specific financial benefits to, or impose specific financial burdens on, the State.

#### b. Financial Statement Presentation

Under fund accounting, the accounts of the component units of the State of Michigan are organized on the basis of funds, each of which is

considered a separate accounting entity. MEDC's operations are accounted for in a separate set of self-balancing accounts that comprise its assets, liabilities, net assets, revenues, and expenses. Government resources are allocated to and accounted for in separate funds, based upon the purposes for which they are to be spent and the means by which spending activities are controlled.

MEDC is a proprietary fund. Proprietary funds are accounted for using a flow of economic resources measurement focus and the accrual basis of accounting. The accounting objectives are a determination of net income, financial position, and cash flow. All assets and liabilities associated with proprietary fund activities are included on the statement of net assets.

Proprietary funds are used to account for operations that are financed and operated in a manner similar to private business enterprises, i.e., where the intent of the governing body is that the costs (expenses) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges or where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

The accompanying financial statements present only MEDC. Accordingly, they do not purport to, and do not, present fairly the financial position and the changes in financial position and cash flows of the State of Michigan or its component units in conformity with generally accepted accounting principles.

c. Measurement Focus and Basis of Accounting

The financial statements contained in this report are presented using the economic resources measurement focus and the accrual basis of accounting as provided by generally accepted accounting principles applicable to governments. Under the accrual basis of accounting, revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of cash flows.

d. Financial Data

The MSF Board of Directors entered into an interlocal agreement with a local unit of government to create MEDC. MEDC came into existence on April 5, 1999. In accordance with the terms of the agreement, substantial assets, liabilities, and fund balances of MSF were transferred to MEDC on May 1, 1999. All revenues received from tribal gaming, industrial development revenue bond (IDRB) issuance fees, and other sources are transferred to MEDC on a monthly basis. This interlocal agreement also detailed all of MSF's State classified employees to MEDC. State appropriations available to MSF for this purpose are also made available to MEDC, as needed. MEDC financial statements include transactions recorded using all appropriated funds, except the Community Development Block Grants (CDBG) Program transactions as required by the federal granting agency. Revenues from the U.S. Department of Labor for the Employment Service grant are received by MSF and transferred to MEDC to fund program expenditures.

MEDC financial statements primarily present the following:

- (1) Cash and Cash Equivalents: The amount reported as "Cash and cash equivalents at end of year" on the statement of cash flows is equal to the total of the amounts reported on the statement of net assets for the line items entitled "Cash," "Equity in common cash," "Capital Access Program - Cash," "Short-term notes," and "Capital Access Program - Reserve."
- (2) Investments: Generally, marketable investments are reported at fair value, consistent with the provision of GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. Other nonmarketable investments are reported at cost.
- (3) Loans Receivable: Loans receivable are reported net of allowance for losses.

- (4) Capital Assets: Capital assets, which mainly include a building, furniture, and equipment, are reported at historical cost, net of depreciation.
- (5) Operating Revenues: Revenues from federal grants, other restricted sources, amounts available to MEDC from State appropriations, tribal gaming revenue (see Notes 3 and 8), and investment earnings. Also included in operating revenues are IDR B issuance fees and Michigan Economic Growth Authority (MEGA) and Brownfield fees collected by MSF and transferred to MEDC during the fiscal year.
- (6) Operating Expenses: Expenses related to program grants funded by State appropriations and MEDC nonappropriated funds. Also included in operating expenses are administrative expenses (including payables) incurred out of appropriated funds, except for the CDBG Program.

## Note 2 Deposits and Investments

### a. General Information

MEDC's investment policy allows investments in the following investment types:

- (1) Securities issued or guaranteed by the U.S. government or its agencies.
- (2) Bonds or other obligations of any U.S. state or any local unit of government of any such state.
- (3) Preferred stock issued by U.S. corporations.
- (4) Repurchase agreements fully collateralized by U.S. government securities.
- (5) Corporate and bank debt including, but not limited to, commercial paper, certificates of deposit, banker's acceptances, and other short-term obligations.

- (6) Corporate notes and bonds.
- (7) Taxable bond funds.
- (8) Money market mutual fund shares that offer daily purchase and redemption and maintain a constant share price.
- (9) Common stock of U.S. corporations.
- (10) Stock mutual funds with portfolios highly concentrated in securities of U.S. corporations.

b. Deposits

GASB Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements*, requires certain disclosures regarding policies and practices with respect to deposits and investments and the custodial credit risk associated with them.

In accordance with GASB Statement No. 3, deposits are classified into three categories of credit risk as follows:

- Category 1: Insured or collateralized with securities held by the entity or by its agent in the entity's name.
- Category 2: Collateralized with securities held by the pledging financial institution's trust department or agent in the entity's name.
- Category 3: Uncollateralized. (This includes any bank balance that is collateralized with securities held by the pledging financial institution, or by its trust department or agent but not in the entity's name.)

MEDC's deposits and investments at September 30, 2004 were:

	Deposits	Investments
Current Deposits and Investments:		
Equity in State of Michigan common cash	\$ 74,124,915	\$
Checking	70,041	
Capital Access Program - Cash	442,399	
Capital Access Program - Reserve	5,614,856	
Short-term notes		4,242,693
Marketable securities		22,796,477
Total Current Deposits and Investments	\$ 80,252,211	\$ 27,039,170
Long-term securities		31,239,900
Total Deposits and Investments	\$ 80,252,211	\$ 58,279,070

Deposits included in MEDC's bank accounts (without recognition of outstanding checks or deposits in transit) were \$8,559,082 at September 30, 2004 (\$8,787,453 at September 30, 2003). Of that amount, \$2,651,166 (\$3,120,381 at September 30, 2003) was covered by federal depository insurance and was classified in GASB credit risk category 1. The remaining \$5,907,916 (\$5,667,072 at September 30, 2003) was uninsured and uncollateralized at September 30, 2004 and was classified in GASB credit risk category 3.

The equity in common cash, which is managed by the State Treasurer, represents State appropriated funds (General Fund and tobacco revenues for the Life Sciences Program) that were committed for several grant programs but not spent (disbursed) at the end of the fiscal year.

As of September 30, 2003, MEDC's total deposits and investments were \$138,708,669 and \$61,133,157, respectively.

c. Investments

All marketable investments are carried at fair value.

Equity investments in business and industrial development corporations (BIDCOs) are carried at the lower of aggregate cost or fair value. MEDC has determined that cost will be used to approximate fair value.

In accordance with GASB Statement No. 3, investments are also classified into three categories of credit risk as follows:

Category 1: Insured or registered, or securities held by the entity or its agent in the entity's name.

Category 2: Uninsured and unregistered, with securities held by the counterparty's trust department or agent in the entity's name.

Category 3: Uninsured and unregistered, with securities held by the counterparty, or by its trust department or agent but not in the entity's name.

The following table shows the fair value of investments at September 30, 2004 by investment type and in total and does not include the checking account balances:

Investment Type	GASB Credit Risk Category			Not	Fair Value
	1	2	3	Categorized	
Corporate securities	\$	\$	\$10,852,538	\$	\$10,852,538
Government securities			19,383,053		19,383,053
Equity	1,780,010				1,780,010
Mutual funds				13,062,917	13,062,917
Other nonmarketable investments				13,200,552	13,200,552
Total Investments	<u>\$1,780,010</u>	<u>\$ 0</u>	<u>\$30,235,591</u>	<u>\$26,263,469</u>	<u>\$58,279,070</u>

The fair value of investments at September 30, 2003 was \$61,133,157, of which \$2,368,707 and \$32,321,964 were recorded in GASB credit risk category 1 and category 3, respectively, and \$26,442,486 was not categorized in any risk category.

MEDC makes grant commitments as a part of its economic development mission. These commitments are paid from the proceeds of the investments held in short-term and long-term securities. The timing of cash required for program commitments is dependent upon the completion of projects. Investments held in long-term securities are made to maximize the earnings. However, the intent of the investment is not to

hold it long term considering the cash flow needs to meet grant commitments. For this reason, investments have frequent turnover. Therefore, the proceeds from sales and purchases of all investments are shown as a net balance on the statement of cash flows.

Note 3 Revenues From MSF

Revenues from MSF consisted of the following:

	Fiscal Year	
	2003-04	2002-03
Tribal gaming revenue, fees, etc.	\$ 2,814,491	\$ 14,289,508
Federal revenue - Employment Service	659,741	777,224
State's General Fund appropriation	37,687,759	52,154,078
State's restricted appropriation	345,104	506,206
State's tobacco revenue appropriation	10,000,000	32,500,000
Total Revenues From MSF	<u>\$ 51,507,095</u>	<u>\$ 100,227,016</u>

Tribal gaming revenue, received from MSF, decreased significantly during fiscal year 2003-04 because the two tribes remitting funds to MSF under the 1998 compact placed these revenues into an escrow account rather than submitting them to MSF. The tribes contend that the Club Keno game, introduced by the State Lottery, violates the compact agreement. Based on information provided by the tribes, MSF estimated that the tribes placed approximately \$10.7 million into the escrow account relating to fiscal year 2003-04.



Note 4 Loans Receivable

Loans receivable consisted of the following:

	As of September 30	
	2004	2003
Urban Land Assembly Fund loans	\$ 6,362,820	\$ 6,530,786
Seed capital loan	3,400,000	3,400,000
BIDCO loans	873,734	997,365
Life Sciences Program	12,867,357	6,829,728
Michigan Core Community Fund Program	13,309,679	9,276,518
Other loans	12,006,400	12,896,102
Total	\$ 48,819,990	\$ 39,930,499
Less: Allowance for uncollectible loans	(11,918,900)	(11,921,102)
Total Loans Receivable	\$ 36,901,090	\$ 28,009,397

The seed capital loan is an uncollateralized, 10-year term loan (which can be extended) bearing interest at 9% per annum with a balloon payback required at the end of the loan period.

BIDCO and other loans are collateralized loans bearing varying rates of interest and repayment terms.

Loans included in the "Other loans" category are collateralized, for qualifying projects, on the basis of participating up to 50% with other public or private lenders. The loans are due under varying repayment terms, including interest at predominantly 9.5% per annum.

The current portion of loans receivable includes those payments expected to be received during the next fiscal year.

MEDC provided no additional allowance during the fiscal year ended September 30, 2004 for loans receivable that MEDC expected to be converted to grants or uncollectible. Loan provisions are reduced for the amounts recovered, BIDCO credits, and write-offs for the nonperforming loans. These loans generally provide for no principal or interest payments during the term of the loans. Some of these loans are expected to be converted to grants at the end of their term provided that certain conditions are met by the borrowers. The conditions generally require the borrowers to continue to conduct their

principal business activities in the State of Michigan and submit specified reports to MEDC.

Note 5 Capital Assets

MEDC recorded its capital assets at cost and depreciates them over their useful lives using the straight-line depreciation method. Capital asset activities for the fiscal year ended September 30, 2004 were as follows:

Capital Assets	Beginning Balance	Increases	Decreases	Ending Balance
Building and improvement	\$ 13,086,970	\$	\$	\$ 13,086,970
Furniture	2,430,971	51,792		2,482,763
Non-EDP equipment	78,265			78,265
EDP equipment	708,981	64,584		773,565
Capital assets (cost)	<u>\$ 6,305,188</u>	<u>\$ 116,376</u>	<u>\$ 0</u>	<u>\$ 16,421,564</u>
Less accumulated depreciation for:				
Building and improvement	\$ (898,335)	\$ (436,608)	\$	\$ (1,334,942)
Furniture	(1,659,876)	(755,471)		(2,415,347)
Non-EDP equipment	(54,351)	(23,914)		(78,265)
EDP equipment	(462,972)	(188,828)		(651,800)
Total Accumulated Depreciation	<u>\$ (3,075,533)</u>	<u>\$ (1,404,821)</u>	<u>\$ 0</u>	<u>\$ (4,480,355)</u>
Capital assets (net)	<u>\$ 13,229,654</u>	<u>\$ (1,288,445)</u>	<u>\$ 0</u>	<u>\$ 11,941,209</u>

Capital asset activities for the fiscal year ended September 30, 2003 were as follows:

Capital Assets	Beginning Balance	Increases	Decreases	Ending Balance
Building and improvement	\$ 13,053,793	\$ 33,177	\$	\$ 13,086,970
Furniture	2,430,971			2,430,971
Non-EDP equipment	78,265			78,265
EDP equipment	664,851	44,130		708,981
Capital assets (cost)	<u>\$ 16,227,881</u>	<u>\$ 77,307</u>	<u>\$ 0</u>	<u>\$ 16,305,188</u>
Less accumulated depreciation for:				
Building and improvement	\$ (462,356)	\$ (435,978)	\$	\$ (898,335)
Furniture	(849,552)	(810,324)		(1,659,876)
Non-EDP equipment	(28,262)	(26,088)		(54,351)
EDP equipment	(235,226)	(227,746)		(462,972)
Total Accumulated Depreciation	<u>\$ (1,575,397)</u>	<u>\$ (1,500,137)</u>	<u>\$ 0</u>	<u>\$ (3,075,533)</u>
Capital assets (net)	<u>\$ 14,652,484</u>	<u>\$ (1,422,830)</u>	<u>\$ 0</u>	<u>\$ 13,229,654</u>

**Note 6 Long-Term Liabilities**

Long-term liabilities are accrued when incurred in proprietary funds (using the accrual basis of accounting). The following table summarizes Capital Access Program and compensated absences liabilities of MEDC for the fiscal year ended September 30, 2004:

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Capital Access Program	\$ 7,689,002	\$ 858,773	\$2,932,919	\$5,614,856	\$2,000,000
Compensated absences	\$ 1,763,847	\$1,454,220	\$1,000,436	\$2,217,632	\$1,541,810

The following table summarizes Capital Access Program and compensated absences liabilities of MEDC for the fiscal year ended September 30, 2003:

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Capital Access Program	\$11,703,134	\$2,285,972	\$6,300,104	\$7,689,002	\$4,000,000
Compensated absences	\$ 2,251,672	\$ 776,484	\$1,264,309	\$1,763,847	\$ 942,345

Note 7 Pension Plans

State classified employees detailed to MEDC are covered by the plans offered by the State of Michigan. Detailed information regarding the plan descriptions, accounting policies, vesting and eligibility requirements, actuarial cost methods and assumptions, funding status and requirements, and 10-year historical trend information are provided in the *SOMCAFR* and the plans' detailed financial reports, issued by the Office of Retirement Services, Department of Management and Budget.

MEDC offers a defined contribution plan (under the Internal Revenue Service Code Section 401(A)) for the non-detailed employees. MEDC contributes 8% of the gross wages to the accounts of eligible employees. As of September 30, 2004, 29 employees were eligible to receive contributions. MEDC's contributions to the plan were current. MEDC also offers a 457 deferred compensation plan to these employees. As of September 30, 2004, 26 employees participated in this plan. MEDC does not make any contributions to the 457 plan. Both plans are administered by a third party administrator and the employees manage their own investments.

Note 8 Tribal Gaming Revenue

Under a consent judgment reached between the Keweenaw Bay Indian Community, the U.S. Department of the Interior, the U.S. Department of Justice, and the Governor, MEDC receives a semi-annual payment from the Keweenaw Bay Indian Community in an amount equal to 8% of the net win derived from all class III electronic games of chance. During fiscal year 2003-04, MEDC received \$2.5 million in such revenue (\$2.6 million in fiscal year 2002-03).

Note 9 Commitments

Of the total net assets (\$166,628,460 and \$220,851,772, respectively), a portion is committed for the following economic development projects as of September 30, 2004 and September 30, 2003:

	2004	2003
Access Technology - North Coast	\$ 350,000	\$ 450,000
Automotive Technological Accelerator	1,310,000	1,800,000
Biosciences Research and Commercialization		10,000,000
Center for Michigan's Renaissance	260,256	824,718
Core Communities II	10,621,000	
Detroit Downtown Development Authority	2,050,858	2,050,858
Economic Development Job Training Program	12,986,098	15,521,897
Emerging Technology Fund	797,448	1,355,802
Life Sciences Program	50,134,879	60,634,143
Marketing	1,090,011	6,000,000
Michigan Core Community Fund Program	3,366,774	16,370,742
Michigan Growth Fund	477,993	1,904,875
Minority Investments	3,824,719	3,795,008
Small Business/Technology	6,897,500	
SmartZone Initiatives	939,000	3,140,000
Technology Centers (M-TECs)		3,022,106
Technology Transfer Program	100,000	300,000
Technology Tri-corridor		10,000,000
University Matching Research	1,388,000	
Urban Land Development	2,139,078	1,944,291
Total	\$ 98,733,614	\$ 139,114,400

Note 10 Related Party Transactions

When MEDC was created, it assumed ownership of an investment in a venture capital firm from MSF. One of the members on the MEDC Executive Committee is also a general partner of that venture capital firm. The investment was made through the ordinary course of business prior to that member's appointment to the MEDC Executive Committee. As of September 30, 2004 and September 30, 2003, the investment was recorded on the statement of net assets as a noncurrent asset in the amount of \$2,418,476 and \$2,700,055, respectively. There have been no related party transactions with this firm during fiscal years 2003-04 and 2002-03.

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# SUPPLEMENTAL FINANCIAL SCHEDULE

**MICHIGAN ECONOMIC DEVELOPMENT CORPORATION**  
Schedule of Expenditures of Federal Awards (1)  
For the Period October 1, 2002 through September 30, 2004

			For the Fiscal Year Ended September 30, 2003		
Federal Agency/Program	CFDA (2) Number	Pass-Through Identification Number	Directly Expended	Distributed to Subrecipients	Total Expended and Distributed
<b><u>U.S. Department of Commerce</u></b>					
Direct Program:					
Manufacturing Extension Partnership	11.611		\$	\$ 2,223,078	\$ 2,223,078
<b>Total U.S. Department of Commerce</b>			<b>\$ 0</b>	<b>\$ 2,223,078</b>	<b>\$ 2,223,078</b>
<b><u>U.S. Department of Labor</u></b>					
Pass-Through Program:					
Michigan Strategic Fund					
Employment Service	17.207	205-Y01	\$ 777,224	\$	\$ 777,224
<b>Total U.S. Department of Labor</b>			<b>\$ 777,224</b>	<b>\$ 0</b>	<b>\$ 777,224</b>
Total Expenditures of Federal Awards			<b>\$ 777,224</b>	<b>\$ 2,223,078</b>	<b>\$ 3,000,302</b>

(1) Basis of Presentation: This schedule includes the federal grant activity of the Michigan Economic Development Corporation and is presented on the accrual basis of accounting. This information is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts may differ from amounts presented in, or used in the preparation of, the financial statements.

(2) CFDA is defined as *Catalog of Federal Domestic Assistance*.



For the Fiscal Year Ended September 30, 2004			Total Expended and Distributed for the Two-Year Period
Directly Expended	Distributed to Subrecipients	Total Expended and Distributed	
\$	\$ 2,335,445	\$ 2,335,445	\$ 4,558,523
<b>\$ 0</b>	<b>\$ 2,335,445</b>	<b>\$ 2,335,445</b>	<b>\$ 4,558,523</b>
\$ 659,741	\$	\$ 659,741	\$ 1,436,965
<b>\$ 659,741</b>	<b>\$ 0</b>	<b>\$ 659,741</b>	<b>\$ 1,436,965</b>
\$ 659,741	\$ 2,335,445	\$ 2,995,186	\$ 5,995,488

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# INDEPENDENT AUDITOR'S REPORTS ON INTERNAL CONTROL AND COMPLIANCE



STATE OF MICHIGAN  
OFFICE OF THE AUDITOR GENERAL  
201 N. WASHINGTON SQUARE  
LANSING, MICHIGAN 48913  
(517) 334-8050  
FAX (517) 334-8079

THOMAS H. MCTAVISH, C.P.A.  
AUDITOR GENERAL

## Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters

Mr. Donald Jakeway, President and Chief Executive Officer  
Michigan Economic Development Corporation  
300 North Washington Square  
Lansing, Michigan

Dear Mr. Jakeway:

We have audited the financial statements of the Michigan Economic Development Corporation, a component unit of the State of Michigan, as of and for the fiscal years ended September 30, 2004 and September 30, 2003, as identified in the table of contents, and have issued our report thereon dated March 15, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

### Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Michigan Economic Development Corporation's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

### Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Michigan Economic Development Corporation's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts,

and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Michigan Economic Development Corporation's management, the Legislature, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Sincerely,

A handwritten signature in black ink, reading "Thomas H. McTavish". The signature is fluid and cursive, with a long horizontal line extending from the left side of the name.

Thomas H. McTavish, C.P.A.  
Auditor General  
March 15, 2005



STATE OF MICHIGAN  
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THOMAS H. MCTAVISH, C.P.A.  
AUDITOR GENERAL

Independent Auditor's Report on Compliance With  
Requirements Applicable to Each Major Program  
and on Internal Control Over Compliance in  
Accordance With OMB Circular A-133

Mr. Donald Jakeway, President and Chief Executive Officer  
Michigan Economic Development Corporation  
300 North Washington Square  
Lansing, Michigan

Dear Mr. Jakeway:

Compliance

We have audited the compliance of the Michigan Economic Development Corporation, a component unit of the State of Michigan, with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each major federal program for the two-year period ended September 30, 2004. The Michigan Economic Development Corporation's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each major federal program is the responsibility of the Michigan Economic Development Corporation's management. Our responsibility is to express an opinion on the Michigan Economic Development Corporation's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to in the previous paragraph that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Michigan Economic Development Corporation's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Michigan Economic Development Corporation's compliance with those requirements.

In our opinion, the Michigan Economic Development Corporation complied, in all material respects, with the requirements referred to in the first paragraph that are applicable to each major federal program for the two-year period ended September 30, 2004.


#### Internal Control Over Compliance

The management of the Michigan Economic Development Corporation is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Michigan Economic Development Corporation's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations, contracts, and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the Michigan Economic Development Corporation's management, the Legislature, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Sincerely,

A handwritten signature in black ink, reading "Thomas H. McTavish". The signature is fluid and cursive, with a long horizontal line extending from the end.

Thomas H. McTavish, C.P.A.

Auditor General

March 15, 2005

## SCHEDULE OF FINDINGS AND QUESTIONED COSTS



## Section I: Summary of Auditor's Results

### Financial Statements

Type of auditor's report issued:	Unqualified*
Internal control* over financial reporting:	
Material weaknesses* identified?	No
Reportable conditions* identified that are not considered to be material weaknesses?	None reported
Noncompliance or other matters material to the financial statements?	No

### Federal Awards

Internal control over major programs:	
Material weaknesses identified?	No
Reportable conditions identified that are not considered to be material weaknesses?	None reported
Type of auditor's report issued on compliance for major programs:	Unqualified
Any audit findings disclosed that are required to be reported in accordance with U.S. Office of Management and Budget (OMB) Circular A-133, Section 510(a)?	No

Identification of major programs:

<u>CFDA Number</u>	<u>Name of Federal Program</u>
11.611	Manufacturing Extension Partnership
17.207	Employment Service

Dollar threshold used to distinguish between type A and type B programs:	\$300,000
Auditee qualified as a low-risk auditee*?	No

\* See glossary at end of report for definition.

## **Section II: Findings Related to the Financial Statements**

We did not report any findings related to the financial statements.

## **Section III: Findings and Questioned Costs\* Related to Federal Awards**

We did not report any findings or questioned costs related to federal awards.

**The status of the findings related to federal awards that were reported in prior Single Audits is disclosed in the summary schedule of prior audit findings.**

*\* See glossary at end of report for definition.*

## OTHER SCHEDULES

MICHIGAN ECONOMIC DEVELOPMENT CORPORATION  
Summary Schedule of Prior Audit Findings  
As of September 30, 2004

**PRIOR AUDIT FINDINGS RELATED TO THE FINANCIAL STATEMENTS**

There were no findings related to the financial statements in the prior Single Audit.

**PRIOR AUDIT FINDINGS RELATED TO FEDERAL AWARDS**

Audit Findings That Have Been Fully Corrected:

**Audit Period:** October 1, 2000 through September 30, 2002

**Finding Number:** 07M0301

**Finding Title:** Subrecipient Monitoring

**Finding:** The Michigan Economic Development Corporation (MEDC) had not established controls to ensure that grant agreements were developed and signed on a timely basis.

**Comments:** MEDC has established controls to ensure that grant agreements are developed and signed before funds are disbursed.

MICHIGAN ECONOMIC DEVELOPMENT CORPORATION

Corrective Action Plan

As of March 15, 2005

**FINDINGS RELATED TO THE FINANCIAL STATEMENTS**

There were no findings related to the financial statements for fiscal years 2002-03 and 2003-04.

**FINDINGS RELATED TO FEDERAL AWARDS**

There were no findings related to federal awards for the two-year period ended September 30, 2004.

# GLOSSARY

## Glossary of Acronyms and Terms

BIDCO	business and industrial development corporation.
CDBG	Community Development Block Grants.
<i>CFDA</i>	<i>Catalog of Federal Domestic Assistance.</i>
financial audit	An audit that is designed to provide reasonable assurance about whether the financial schedules and/or financial statements of an audited entity are fairly presented in conformity with the disclosed basis of accounting.
GASB	Governmental Accounting Standards Board.
IDRB	industrial development revenue bond.
internal control	A process, effected by management, designed to provide reasonable assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.
low-risk auditee	As provided for in OMB Circular A-133, an auditee that may qualify for reduced federal audit coverage if it receives an annual Single Audit and it meets other criteria related to prior audit results. In accordance with State statute, this Single Audit was conducted on a biennial basis; consequently, this auditee is not considered a low-risk auditee.
material misstatement	A misstatement in the financial schedules and/or financial statements that causes the schedules and/or statements to not present fairly the financial position or the changes in financial position or cash flows in conformity with the disclosed basis of accounting.

material noncompliance	Violations of laws and regulations that could have a direct and material effect on major federal programs or on financial schedule and/or financial statement amounts.
material weakness	A reportable condition related to the design or operation of internal control that does not reduce to a relatively low level the risk that either misstatements caused by error or fraud in amounts that would be material in relation to the financial schedules and/or financial statements or noncompliance with applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.
MEDC	Michigan Economic Development Corporation.
MSF	Michigan Strategic Fund.
NIST	National Institute of Standards and Technology.
OMB	U.S. Office of Management and Budget.
questioned cost	A cost that is questioned by the auditor because of an audit finding: (1) which resulted from a violation or possible violation of a provision of a law, regulation, contract, grant, cooperative agreement, or other agreement or document governing the use of federal funds, including funds used to match federal funds; (2) where the costs, at the time of the audit, are not supported by adequate documentation; or (3) where the costs incurred appear unreasonable and do not reflect the actions a prudent person would take in the circumstances.
reportable condition	A matter coming to the auditor's attention relating to a significant deficiency in the design or operation of internal control that, in the auditor's judgment, could adversely affect



the entity's ability to (1) initiate, record, process, and report financial data consistent with the assertions of management in the financial schedules and/or financial statements or (2) administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants.

Single Audit

A financial audit, performed in accordance with the Single Audit Act Amendments of 1996, that is designed to meet the needs of all federal grantor agencies and other financial report users. In addition to performing the audit in accordance with the requirements of auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, a Single Audit requires the assessment of compliance with requirements that could have a direct and material effect on a major federal program and the consideration of internal control over compliance in accordance with OMB Circular A-133.

*SOMCAFR*

*State of Michigan Comprehensive Annual Financial Report.*

subrecipient

A nonfederal entity that expends federal awards received from another nonfederal entity to carry out a federal program.

unqualified opinion

An auditor's opinion in which the auditor states that:

- a. The financial schedules and/or financial statements presenting the basic financial information of the audited agency are fairly presented in conformity with the disclosed basis of accounting; or
- b. The financial schedules and/or financial statements presenting supplemental financial information are fairly stated in relation to the basic financial schedules and/or

financial statements. In issuing an "in relation to" opinion, the auditor has applied auditing procedures to the supplemental financial schedules to the extent necessary to form an opinion on the basic financial schedules and/or financial statements, but did not apply auditing procedures to the extent that would be necessary to express an opinion on the supplemental financial schedules taken by themselves; or

- c. The audited agency complied, in all material respects, with the cited requirements that are applicable to each major federal program.

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